

Statement of John L. Mica  
Commercial Jet Fuel Supply:  
Impact and Cost on the U.S. Airline Industry

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One of the principle reasons why the U.S. airline industry lost an estimated \$10 billion last year is the supply and cost of commercial jet fuel, which is the subject of our hearing today.

America's commercial aviation industry was nearly brought to its knees last year when Hurricanes Katrina and Rita crippled our Gulf Coast refineries and two major pipelines. The resulting supply disruption propelled commercial jet fuel prices to a record-high of \$3.13 per gallon. In January 2005, the average market price of a gallon of commercial jet fuel was \$1.33. To put this into perspective, every penny increase in the price of a gallon of jet fuel results in an additional \$195 million in annual fuel costs for the U.S. airline industry.

Airlines cannot be profitable when the average price for jet fuel exceeds \$70 per barrel, or about \$1.67 per gallon. The average price for commercial jet fuel was about \$72 per barrel, or \$1.81-per-gallon, last month. The price of commercial jet fuel has more than doubled over the last five years.

In order for the U.S. airline industry to reverse its recent string of multi-billion-dollar annual losses, several critical challenges relating to jet fuel must be addressed by government and industry initiatives: (1) stabilization of jet fuel prices; (2) expansion of our domestic refining capacity; (3) improvements to the nation's oil and refined product distribution network; and (4) further gains in commercial aircraft fuel efficiency.

There are many reasons why the cost of jet fuel remains at record highs. It is more expensive and less profitable for a limited number of U.S. refiners to produce jet fuel. Another factor is the high cost of crude oil, from which jet fuel is refined. Although oil costs remain high for many reasons, most industry analysts cite limited U.S. refining capacity, increased demand from India and China, and geo-political events.

Jet fuel supply problems were compounded last fall by Hurricanes Katrina and Rita, which eliminated about 25 percent of the domestic jet fuel production capacity. The jet fuel supply problem following the hurricanes prompted some oil and aviation industry analysts to propose the creation of a jet fuel reserve similar to the existing Strategic Petroleum Reserve.

With the damaging impact of soaring oil prices and in light of the jet fuel supply crisis following the hurricanes, I believe we should seriously consider establishing a jet fuel reserve. I understand many European countries have taken similar measures to ensure an adequate supply of fuel.

Although most of the U.S. jet fuel supply is refined in the U.S., 60 percent of our oil supply is imported. Oil prices will no doubt increase further if Iran, the world's fourth largest exporter of oil, follows through on its recent threat to stop exporting oil to the U.S. due to diplomatic concerns over Iran's nuclear weapons program. A major terrorist attack in the Middle East would also have an adverse effect on our oil supply and result in even higher jet fuel costs for the airline industry.

I am also concerned that the U.S. jet fuel supply is being further constrained by the export of U.S.-produced jet fuel abroad, where jet fuel is even more profitable. At least one U.S. producer has taken voluntary steps to restrict exports other producers have not.

Regrettably, regulators in Washington are also contributing to higher jet fuel prices and supply problems.

The Department of Energy recently warned that the distribution of jet fuel and other refined petroleum products may be impeded later this year due to the phase-in of more emissions-friendly, ultra low sulfur diesel fuel mandated by the Environmental Protection Agency.

Suppliers and refiners will have to take special measures to prevent the contamination of ultra low sulfur diesel during the petroleum refining process, as well in the storage and transport of jet fuel and other refined products. The added cost of these measures most likely will be passed on to the airlines in the form of higher jet fuel market prices later this year.

Another regulatory threat to jet fuel price stability in 2006 is a proposed increase in the standard Federal Energy Regulatory Commission tariff rate that owners and operators of oil and refined product pipelines can charge their customers. Virtually every drop of commercial jet fuel passes through the nation's vast network of pipelines. Ironically, I understand that stronger pipeline security mandates from the Department of Transportation is one of the main reasons why the major pipeline association is seeking a higher-than-usual tariff rate this year.

Although the result of these new regulatory burdens could be just a penny or two increase in the cost of jet fuel, as I mentioned previously, this is significant for airlines given that every one-cent increase in the price of jet fuel adds \$195 million to the operating costs of U.S. airlines.

If jet fuel prices had remained at 2004 levels last year, the U.S. airline industry would have recorded a profit instead of an estimated \$10 billion loss. The airline industry could make a strong recovery if jet fuel costs stabilize in the \$60-per-barrel range.

One creative way the airline industry has coped with rising jet fuel costs is through the practice of “hedging”, in which airlines lock in a fixed price or maximum cap for fuel in the future by buying a contract at a specified price. Due to hedges made when jet fuel prices were low, Southwest Airlines and Alaska Airlines are currently paying between 40 and 48 percent less for a significant portion of their current fuel needs. Unfortunately, legacy carriers have not had the cash or creditworthiness to pay for fuel hedge contracts.

With oil prices so high for so long, fuel hedges will be almost non-existent by 2010. By this time, the core business of the airline industry will be the one-way ticket to sustained profitability.

Although there is little that the Federal Government can do in the short-term to lower oil prices, industry and government can work in tandem to (1) stabilize the U.S. jet fuel supply by possibly establishing a jet fuel reserve; (2) lower regulatory barriers that impede the nation's oil and refined product distribution network; (3) increase domestic refining capacity; and (4) reduce demand by taking steps to further improve commercial aircraft fuel efficiency.

I also have directed subcommittee staff to look further into the various factors behind the soaring cost of commercial jet fuel.

U.S. airlines have improved fuel efficiency by 18 percent over the last five years by changing operating procedures and utilizing technology to make their aircraft more fuel efficient. In addition, the use of composites and other advanced aircraft manufacturing technologies will make future commercial jetliners more fuel efficient. We will hear more about this development today from Mr. Jeffrey Hawk from Boeing.

This subcommittee, through its oversight responsibilities, can help airlines further improve fuel efficiency by ensuring that certain air traffic control modernization programs remain on track and on-budget. Mr. Michael Cirillo from the FAA's Air Traffic Organization is here to discuss these programs in greater detail.

Finally, I am concerned about reports that the operator of London Heathrow Airport, BAA, is engaged in a fuel rationing scheme that discriminates against U.S. airlines. The fuel rationing system was established after a fire and explosion damaged the airport's major fuel depot in December. Perhaps Mr. John Heimlich of the Air Transport Association, who is testifying on our second panel, can give us an update on this situation.

I now recognize the Ranking Member of the Subcommittee, Mr. Costello.